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The Oil Patch

Reports and Research Memoranda

Archives

Richard A. Fineberg

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How to Shoot Both Feet with the Same Bullet

In 8 Weeks Since Mar. 5 Hearing, Failure To Remedy TAPS Tariff Policy Has Cost State Treasury $30 Million; Hemorrhage Continues at more than $500,000 per day

> ***While Governor and Legislature dream of a gas line, neglect of oil pipeline tariff overcharges diminishes State Treasury -- and chances for gas pipeline***

By RICHARD FINEBERG
April 28, 2007

Since the State House Resources Committee met March 5 to consider the stinging rebuke to the owners of the Trans-Alaska Pipeline System (TAPS) delivered by the staff of the Federal Energy Regulatory Commission (FERC), excess TAPS tariffs (shipping charges) have cost the State Treasury another $30 million. As explained in the following guest editorial (versions of which appeared in the *Anchorage Daily News*, the *Fairbanks Daily News-Miner* and the *Juneau Empire* between April 19 and April 26), from a public policy standpoint TAPS tariff overcharges constitute a double whammy. In addition to the ongoing loss of revenue - conservatively estimated at $400 per minute - the state's long-running failure to ensure that independent shippers will be not be forced to pay excessive tariffs to bring North Slope petroleum products to market sends a bad signal to prospective explorers and developers --the very companies on whom the state is counting to convert the long-sought North Slope natural gas pipeline project from dream to reality. *(Continued in left column.)*

Feb. 28 Report: ***State Losing $404 per Minute in Reduced Royalties and Taxes due to Excess TAPS Tariffs***

Comment: TAPS Tariff Policy Needs Overhaul (posted Mar. 4, 2007)

Analysis and Comment on Mar. 5 Hearing (posted Mar. 10, 2007)

-- *Fairbanks Daily News-Miner*, April 20, 2007 (p. A4) --

Community Perspective:
Throwing good money after bad

Richard Fineberg

Everybody knows: throwing good money after bad isn't smart. But state bureaucracy seems to operate on different rules. Consider the continued failure to stop the massive, ongoing hemorrhage of state revenue caused by excessive Trans-Alaska Pipeline

Welcome

System (TAPS) shipping charges . . . .

Every dollar of TAPS overcharges reduces state royalty and tax revenue by approximately 25 cents. The principal beneficiaries are BP, ConocoPhillips and ExxonMobil, who own approximately 96 percent of TAPS and control a similar portion of North Slope production. The prospect of paying those overcharges out of pocket also curbs interest in North Slope exploration by independent developers.

The root of the problem is the complex and controversial 1985 TAPS Settlement Agreement (TSA) between the TAPS owners and the state, represented by the Department of Law and its highly paid consultants.

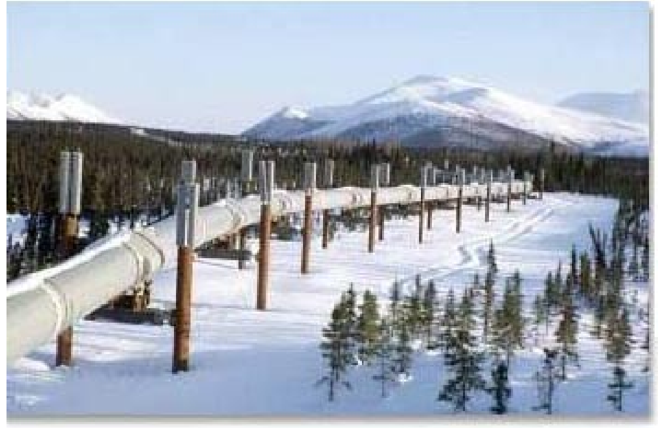
In 2002, the Regulatory Commission of Alaska (RCA) determined that the TAPS owners were charging far too much for transporting oil from the North Slope to Valdez under the terms of the 1985 settlement.

Based on commission data, I estimate that since 1977 TAPS overcharges have enabled the pipeline owners to pocket - at state expense - at least $4.5 billion more in 2007 dollars than the amount necessary to repay all costs, plus a reasonable return on their investment. Today, excessive TAPS tariffs continue to cost the state treasury approximately $400 per minute - more than $500,000 per day.

The regulatory commission, a quasi-independent state agency, only has authority over TAPS oil destined for in-state refiners, or approximately 11 percent of total shipments through the pipeline system. Tariffs on 89 percent of TAPS oil fall under the jurisdiction of the Federal Energy Regulatory Commission (FERC), which still uses the 1985 settlement agreement to set tariffs.

The TAPS owners went to court to appeal the RCA's 2002 order.

In 2006 a Superior Court judge rejected the TAPS owners' arguments, upholding the RCA decision "in all respects." The TAPS owners continued their protest to the Alaska Supreme Court, where a decision is still months away. Meanwhile, for most of the oil regulated by FERC under the terms of the 1985 settlement, the TAPS owners have dramatically increased TAPS tariffs.



At this web site you will find fact-based information about economic and environmental aspects of oil industry operations in Alaska, with special emphasis on the North Slope oil fields and the Trans-Alaska Pipeline System (TAPS), which provides about one million barrels of oil per day (five percent of the nation's total consumption) to the West Coast. Due to the oil industry's power, political clout and media skills, much of the information you will find here is not widely reported or readily available elsewhere.

Three major petroleum companies -- BP, ConocoPhillips and ExxonMobil (originally Sohio, ARCO and Exxon) -- control more than 90 percent of the North Slope production and own a similar share of the Alyeska Pipeline Service Company, which built and operates TAPS. The sprawling North Slope complex centers around Prudhoe Bay, the largest producing oil field ever discovered on the North American continent. About one million barrels of oil per day is pumped from beneath the frozen substrate and loaded into TAPS for the 800-mile journey across Alaska to the ice-free port of Valdez in Prince William Sound. There, the oil is loaded on tankers that carry approximately one-third of the oil consumed daily in the western United States.

Alaska's North Slope development and its pipeline link to market provide unusual opportunities to observe the actions of decision makers, as well as greater access to the central participants than most other places afford. Based on this experience and supplemented by information from two pipeline-dependent petroleum provinces of the Former Soviet Union, the information presented here points to two significant conclusions:

- *(1) petroleum developers can and frequently do use pipelines to maximize profit and inhibit competition, to the detriment of host populations; and*

Two companies with no ownership interest in TAPS - Anadarko, the North Slope's largest independent producer and Tesoro, an independent refiner -have protested the increased TAPS tariffs at FERC and have been joined by the Department of Law on technical grounds. The FERC staff recently weighed in on the side of the protesters, describing TAPS owners' defense of their tariffs in terms such as "silly," "obfuscating" and contrary to FERC precedent. The FERC staff brief is the latest confirmation that the TAPS owners used everything but the kitchen sink and meaningful ratemaking data to justify unreasonably high tariffs.

For most of the decade since Tesoro launched its RCA tariff protest in 1996, the Department of Law case managers, hamstrung by legal conundrums their predecessors helped create, sided with the TAPS owners. Now, as the weight of the decisions against the 1985 settlement accumulates, the Department of Law has belatedly changed course.

But its arguments for lower tariffs seem muted, convoluted and tenuous. Instead of aggressively seeking lower tariffs at FERC, the Department of Law appears to be paddling in the wake of the protesting shippers. Meanwhile, high TAPS tariffs continue to thwart the potential developers the state now courts for gas line development while the state treasury quietly continues to bleed.

The period for renegotiation of TAPS tariff terms officially began January 1.

This is not an issue the state can afford to continue to talk to death. If the state really wants to assure just and reasonable tariffs on TAPS that will encourage potential developers to come north to explore for oil and gas on the North Slope, pipeline tariff case management requires immediate attention.

By funding the Department of Law's feckless tariff maneuvers without rigorous oversight and clear policy guidance, the administration and the Legislature are simply throwing good money after bad, to the detriment of the public interest.

I believe careful review of TAPS tariff history and analysis of recent developments demonstrate that primary responsibility for formulating and executing state pipeline tariff policy should be transferred from the Department of Law and its consultants to the state's resource management agencies.

- *(2) the chronic discrepancy between promise and practice on major oil projects frequently places the populace and the environment at significant and needless risk.*

The material presented here was researched and compiled by Richard A. Fineberg, founder and principal investigator of Research Associates of Ester, Alaska. Fineberg has observed Alaska petroleum development for three decades as a prize-winning reporter, as an advisor to the Governor of Alaska on oil and gas policy and as an independent consultant to investors, government agencies and non-profit organizations. In recent years his horizons have expanded to include two oil provinces in the Former Soviet Union, the Caspian Basin and Sakhalin Island. Often controversial, Fineberg's petroleum research has earned a reputation for dedication to factual accuracy and carefully reasoned analysis.

Richard Fineberg addresses a conference on Caspian petroleum development in Baku, Azerbaijan, May 2003. (Photo: OSI Assistance Fndtn. / Azerbaijan.)

A fundamental premise of this web site is that it falls to each of us, as citizens, to inform ourselves and respond appropriately to the issues and events that shape the broad directions of our society and the detailed fabric of our social interactions. Based on the fact-driven information presented here, readers can come to independent judgments regarding the authenticity of the content, the significance of the relevant facts and the logic and appropriateness of the conclusions. In effect, each of the topics reported here can stand alone as a documented case study in petroleum development.

During the 3-1/2 decades since the discovery of the nation's largest oil field at Prudhoe Bay on Alaska's North Slope, events from Watergate to the collapse of powerful corporate entities such as Enron and

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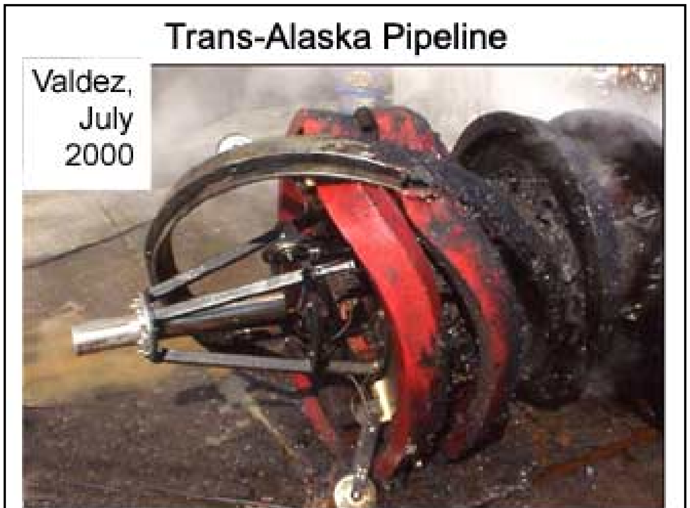
Richard Fineberg, an independent oil and gas analyst from Ester, served as senior policy advisor to the governor on oil and gas policy between 1987 and 1989. In 2001 he presented expert testimony in the RCA TAPS tariff case for the Regulatory Commission of Alaska's Public Advocacy Section. Additional background on TAPS tariff issues can be found at the author's web site . . . .

Inside -- Oil Patch Report:

Arctic Refuge Lease Bonus
Payments Unlikely to Close
Gap between Agency Estimates
And Historical North Slope Bids
(Dec. 20, 2006 Report)

Pigs Behaving Badly



Instrument pig with 48" diameter, 500-lb. steel ring ripped from a check valve near Fairbanks and carried 350 miles to Valdez.

BP in Alaska: 3 Reports

Update Report (May 15, 2007)

The Shutdown (Sept. 3, 2006)

North Slope Spill (March 15, 2006)

WorldCom demonstrate that large institutions frequently fail -- often by grotesque margins -- to live up to legal and moral obligations and to deliver on their public pronouncements. Concurrently, the major oil companies who have played such a large role in Alaska's development have performed their tasks with a chronic and troubling discrepancy between promise and practice. Despite lavishly funded advertising campaigns and public relations efforts urging that Alaska's oil companies can be trusted as the avatars of social salvation, closer examination reveals a profound gap between what these companies say and what they do. With equally disturbing regularity, when confronted with evidence of those failures, government has failed to protect the public interest. This web site explores the economic and environmental impacts of those failures in concrete terms in the belief that well-informed individuals can and will make a positive contribution to the course of human development.

Reports on pipeline and petroleum development issues found in the "Oil Patch" section of this web site may be understood as case studies providing insight into the relationships among powerful corporate and government institutions and the complex interactions between individuals and institutions. At this broad level, a growing body of research on the political and economic aspects of petroleum development known as petropolitics suggests that the price of oil wealth includes, with disturbing frequency, poverty, a widening gap between rich and poor, economic stagnation, corruption, dictatorship and war. The petropolitical approach to petroleum development goes far beyond the conclusions presented here regarding pipeline economics and the industry's chronic discrepancy between promise and practice. While one reader may take the fact-based case studies presented here to support a petropolitical interpretation of petroleum development, another reader may apply the same information to a different understanding of social activity; in any event, these case studies are fact-driven and therefore stand alone.

In sum, the principal purpose of this web site is to gather in one place many of the basic facts regarding the environmental impacts and economic results of oil development in Alaska and elsewhere - information that industry and government prefer to ignore or to spin. Using case studies presented with fidelity to reason and factual accuracy, FinebergResearch.com brings to public attention information about economic and environmental issues related to petroleum development that is not readily available elsewhere.